ST 04-0220-GIL 11/29/2004 COMPUTER SOFTWARE

> A transaction involving the licensing of software will not be considered a taxable retail sale if such transaction meets all the criteria listed in subsection (a)(1)(A-E) of Section 130.1935. See 86 Ill. Adm. Code 130.1935(a)(1) (This is a GIL.)

November 29, 2004

Dear Xxxxx:

This letter is in response to your letter dated December 19, 2003, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.ILTAX.com to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

On behalf of an out-of-state seller of computer software (Seller), we respectfully request a General Information Letter from the Illinois Department of Revenue ('the Department') to help determine if Seller's transfers of software to Illinois customers are taxable or non-taxable. Seller is not under audit by the Department and no litigation involving Seller and the Department is pending.

Seller transfers computer software to customers, including customers located in Illinois, under an Agreement. Seller is registered with the Department and it collects and remits Illinois sales tax on its transfers of software to Illinois customers. Recently, one of Seller's Illinois customers advised Seller that it should not collect Illinois tax on software transferred under the Agreement because the Agreement constitutes a non-taxable software license agreement under the provisions of 86 Ill. Adm. Code 130.1935(a)(1).

A copy of the Agreement, including Exhibit D, is enclosed. [Exhibits A, B, and C are not enclosed because they are cumbersome and have nothing to do with determining whether the Agreement is a software license. However, if you would like to see them, they will be provided.] While two provisions of the Agreement itself are relevant to a determination that it is a software license agreement, Exhibit D is particularly relevant to that determination and is captioned '(Seller's) Software License Agreement'.

We have reviewed the Agreement, including Exhibit D, and we think that:

it satisfies all of the requirements of section 130.1935(a)(1);

it is, therefore, a software license agreement; and

transfers of software under the Agreement, including Exhibit D are exempt from Illinois sales tax.

On behalf of the Seller, we would like to confirm those conclusions with the Department. To that end, the requirements of section 130.1935(a)(1) are set out below in bold type. The provision(s) of the Agreement, including Exhibit D, that satisfy each requirement are as follows:

(A) the license must be 'evidenced by a written agreement signed by the licensor and the customer'

The Agreement, including exhibit D, is in writing and this request for a GIL is conditioned on the fact that the Agreement will be signed by the Seller (licensor) and the customer.

Section 5 of the Agreement explicitly grants a software license under the terms and conditions of Exhibit D to the Agreement. [See 'License' on pages 2 and 3]

Section 1 of Exhibit D also explicitly grants a software license. [See the first sentence of 'Grant of License' on page 54]

Section 1 of the Agreement provides that all references in the Agreement to 'sale' or 'selling of software products means a sale of a license to use software products and that all references to the 'purchase' of software products means the purchase of a license to use software products. [See definition (e) in 'Definitions' on page 1]

(B) the license agreement must restrict '...the customer's duplication and use of the software'

Section 2 of Exhibit D sets out 9 restrictions on the customer's duplication and use of the software. [See 'Restrictions' on page 55]

Section 1 of Exhibit D restricts the customer's duplication of the software. [See 'Backup Copy' on page 54 and 'Additional Installation' on page 54]

Section 1 of Exhibit D restricts the customer's use of the software. [See 'Grant of License'---last sentence of first paragraph on page 54 (single seat license) and 'Network Version' on page 54]

Section 3 of Exhibit D restricts the customer's duplication of the software. [See 'Copyright' on page 55]

(C) the license agreement must prohibit '...the customer from licensing, sublicensing or transferring the software to a third party (except a related third party) without the permission and continued control of the licensor'

Section 2 of Exhibit D contains such a prohibition. [See 'You May Not', item number 3, on page 55]

> **(D) the licensor must have a policy '...of providing another copy at minimal or no charge if the customer loses or damages the software, or of permitting the licensee to make and keep an archival copy, and such policy is either stated in the license agreement supported by the licensor's books and records, or supported by a notarized statement made under penalties of perjury by the licensor'**

Section 1 of Exhibit D authorizes the licensee to '...make an archival (backup) copy of the (s)oftware'. [See 'Backup Copy' on page 54]

> **(E) the license agreement must provide that ' ...the customer must destroy or return all copies of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of** a **perpetual license, without being set forth in the license agreement.'**

This requirement is satisfied for either of two reasons. First, the provisions of the Agreement and Exhibit D provide that the software license is perpetual unless it is breeched by the licensee. Second, if the software license is breeched by the lessee, it is terminated and the licensee must destroy or return the Agreement itself and the software license set out in Exhibit D.

Section 5 of the Agreement (on pages 2 and 3) and section 1 of Exhibit D (on page 54) grant the license pursuant to the terms of the software license agreement set out in Exhibit D.

Section 1 of Exhibit D ('License Term' on page 55) provides that the software license is perpetual unless the software is designated as a fixed term license. There is no place in the Agreement, including Exhibit D, where the software is designated as a fixed term license. Consequently, the license is perpetual and that, in and of itself, satisfies this requirement.

The only place where one might find support for the conclusion that the software license agreement is for a fixed term is Section 9 of the Agreement. Section 9(a) of the Agreement (on page 5) provides that the Agreement is for one year. However, section 9(d) provides that the software license set out in Exhibit D survives termination of the Agreement for all software licensed prior to the termination unless the customer has breeched the terms of Exhibit D. If the customer has breeched the terms of Exhibit D, the software license is terminated and the customer is required to destroy or return the software, including any copies and documentation.

In sum, the software license agreement is perpetual unless the customer breeches it and, in that event, the software license agreement is terminated and the customer must destroy or return the software. In either event, this requirement is satisfied.

In addition, Section 5 of the Agreement provides that when the Seller provides an upgrade, the customer is required to destroy all copies of the previous version. [See provision (c) of 'License' on page 3]

Section 1 of Exhibit D contains the same provision. [See 'Upgrades' on page 54]

Conclusion

For the reasons set out above, we think that the Agreement, including Exhibit D, constitutes a software license agreement and transfers of software made under its terms are not subject to Illinois sales tax liabilities. Your confirmation of that conclusion would be appreciated.

DEPARTMENT'S RESPONSE:

If transactions for the licensing of computer software meet all of the criteria provided in 86 Ill. Adm. Code 130.1935(a)(1), neither the transfer of the software nor the subsequent software updates will be subject to Retailers' Occupation Tax. A license of software is not a taxable retail sale if:

A)   It is evidenced by a written agreement signed by the licensor and the customer;

B)   It restricts the customer's duplication and use of the software;

C)   It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party) without the permission and continued control of the licensor;

D)   The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or permitting the licensee to make and keep an archival copy, and such policy is either stated in the license agreement, supported by the licensor's books and records, or supported by a notarized statement made under penalties of perjury by the licensor; and

E)   The customer must destroy or return all copies of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement.

In the context of a General Information Letter, the Department cannot give you a binding ruling as to whether the agreement you attached to your letter meets the requirements of Section 130.1935. However, it appears that a contract such as the one provided would comply with the requirements of subsection (a)(1) of Section 130.1935.

I hope this information is helpful. If you require additional information, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).]

Sincerely,

Samuel J. Moore
Associate Counsel